(3)

No. 95-1181

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

WILLIAM C. DUNN and DELTA CONSULTANTS, INC.,

Petitioners,

—v.—

COMMODITY FUTURES TRADING COMMISSION, DELTA OPTIONS, LTD. and NOPKINE CO., LTD.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF CRÉDIT LYONNAIS, BANK JULIUS BAER & CO., LTD., THE CHASE MANHATTAN BANK, N.A. AND SOCIÉTÉ GÉNÉRALE, AMICI CURIAE, IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the "Treasury Amendment" (7 U.S.C. § 2(ii)) to the Commodity Exchange Act (7 U.S.C. § 1 *et seq.*)—which provides in pertinent part that "[n]othing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade"—exempts from the jurisdiction of the Commodity Futures Trading Commission *off*-exchange foreign currency options.

PARTIES TO THE PROCEEDING

All parties to this proceeding are identified in the caption.*

* Filed herewith are the consents both of petitioners and respondents to the filing of this *amicus* brief.

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STATEMENT OF INTEREST

Amici are all banks with offices or branches in major money-centers, including New York. All are active, world-wide participants in the over-the-counter foreign currency market. This market, which is not an organized exchange, features global, 24 hour trading in which dealers, such as *amici*, and other participants make large transactions in virtually all

currencies. These transactions are all privately negotiated and settled, typically by telephone or computer. The Bank for International Settlements in its "Central Bank Survey of Foreign Exchange Market Activity" reported that "global net turnover in the world's foreign exchange markets is estimated to have been $880 billion per business day in April 1992" (March, 1993 at p. 1).

Amici also deal in currency options. An option provides the right, but not the obligation, to purchase or sell currency in the future. On organized exchanges, currency options are standardized contracts in which a finite number of currencies and option terms are offered. By contrast, the terms of off-exchange options are freely negotiable and are customized by the parties to suit their particular circumstances. One study estimated *daily* volume of off-exchange currency options in April, 1992 to be $31 billion (*Id.* at 22). Volume is widely believed to have increased since that date. Five times more currency options are traded in privately negotiated, over-the-counter transactions than on organized exchanges (*Id.*). This clear preference for trading currency options over the counter is explained by the flexibility of terms, ease of participation and superior liquidity of that market.

The Petition asks the Court to determine whether the Second Circuit Court of Appeals correctly held that the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.* (the "CEA"), applies to off-exchange trading in currency options. The Second Circuit candidly acknowledged that its decision construing the CEA to have such breadth was in direct conflict with a decision of the Fourth Circuit. Thus, at present, the CEA controls off-exchange foreign currency options trading in New York but not in Baltimore. As active market participants, *amici* have a vital interest in a smoothly functioning currency options market informed by uniform judicial determinations concerning the applicability of the CEA.

Prior to the Second Circuit's decision, it was generally understood that the CEA did not apply to over-the-counter

transactions in currency options, at least between sophisticated institutions. For example, in this case the options trading allegedly occurred between major banks and a $100 million hedge fund. If permitted to stand, the Second Circuit's decision would result in significant costs to market participants such as *amici*,[1] heighten existing uncertainty over the enforceability of billions of dollars of currency options contracts and afford competitive advantages to market participants in other parts of the world who could trade beyond the reach of the CEA.

Amici are also interested parties because they and petitioners William Dunn and Delta Consultants, Inc. ("Dunn/Delta") have been named as defendants in related civil litigation now pending in the United States District Court for the Southern District of New York.[2] That litigation was brought by investors in the hedge fund operated by Dunn/Delta (the "Fund"). The Fund allegedly traded foreign currency options with, among others, *amici*. The plaintiff investors have alleged that *amici* violated the anti-fraud provisions of the CEA.

Amici Crédit Lyonnais and Bank Julius Baer have moved to dismiss the investors' CEA claims on the ground, among others, that the CEA does not apply to the foreign exchange trading activities alleged in the investor complaints. As the

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[1] Those costs include incurring the expense of registration and compliance that attend CFTC regulation, meeting capital requirements imposed by the CEA, being forced to trade on a CFTC designated exchange and exposure to private rights of action under the CEA.

[2] *Amici* were all originally named as defendants in *Sundial International Fund Ltd., et al.* v. *Delta Consultants, Inc., et al.*, 94 Civ. 118 (TPG). Subsequently, claims against *amicus* The Chase Manhattan Bank, N.A. were dismissed without prejudice. *Amici* Crédit Lyonnais and Bank Julius Baer are also defendants in companion suits entitled *Musashi Limited* v. *Delta Consultants, Inc., et al.*, 95 Civ. 3773 (TPG) and *Mablyn Investments Limited* v. *Delta Consultants, Inc., et al.*, 95 Civ. 3774 (TPG).

Petition raises that very issue, *amici* are keenly interested in its disposition.

STATUTORY PROVISION INVOLVED

The "Treasury Amendment" to the CEA, Section 2(a)(1)(A)(ii), codified at 7 U.S.C. § 2(ii), provides as follows:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

STATEMENT OF THE CASE

Amici adopt the statement of the case set forth in the Petition except as to one matter. Petitioners have framed the question and characterized the decisions below as construing the extent of the CFTC's jurisdiction under the Treasury Amendment. The Treasury Amendment does not specifically speak to the CFTC's jurisdiction, but rather more broadly, to whether the CEA as a whole "shall be deemed to govern or in any way be applicable to transactions in foreign currency." The distinction is significant because, in addition to authorizing the CFTC to bring enforcement proceedings, the CEA provides private rights of action.[3]

In determining whether to grant the CFTC's motion to have a receiver appointed, the District Court appropriately considered its own subject matter jurisdiction under the CEA rather than the CFTC's ability to make such a motion (*See* decision reprinted at Appendix p. 6a of the Petition).

[3] *See* Section 22 of the CEA, 7 U.S.C. § 25.

Although the Court of Appeals opinion framed the issue in terms of the CFTC's jurisdiction, the more precise question is whether off-exchange foreign currency options are within the general subject matter jurisdiction of the CEA.

REASONS FOR GRANTING THE WRIT

A. The Court of Appeals Has Obviously Misread an Important Provision of the CEA.

The Treasury Amendment excludes from the Act's coverage, *inter alia*, all "transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." On its face, this language has a broad reach, excluding all off-exchange commerce in foreign currency. But in its decision below, the Court of Appeals read the Treasury Amendment very narrowly. Without elaboration, it simply adhered to its earlier opinion in *Commodity Futures Trading Comm'n* v. *American Board of Trade*, 803 F.2d 1242, (2d Cir. 1986), which briefly concluded (in a case involving exchange traded options) that the words "transactions in foreign currency" do not encompass foreign currency options: "An option transaction giving the option holder the right to purchase a foreign currency by a specified date and at a specified price does not become a 'transaction [ ] in' that currency unless and until the option is exercised." (*Id.* at 1248).

The Second Circuit's interpretation is dramatically inconsistent with the everyday meaning of the words "transaction in foreign currency" and the broad meaning given to "transaction" by the CEA itself. This broad meaning is exemplified in the CEA's jurisdictional section, the subparagraph immediately preceding the Treasury Amendment, which catalogues the commercial activities falling within the CEA.[4] The word

[4] Sec. 2.(a)(1)(A)(i) of the CEA, 7 U.S.C. § 2, states in pertinent part:

> The Commission shall have exclusive jurisdiction, except to the extent otherwise provided in subparagraph (B) of this paragraph,

"transaction" is used in that listing three times. Of relevance here is its first appearance, to help define the word "agreement" to include "any transaction which is of the character of, or is commonly known to the trade as, an 'option'. . ." Plainly, as used in the CEA, an "option" is encompassed within the meaning of "transaction." And, a "currency option" is encompassed by the Treasury Amendment's reference to "transactions in foreign currency."

B. Unless Clarified by the Court, Contradictory Interpretations of the Treasury Amendment Will Adversely Affect the Market.

In the opinion below, the Second Circuit intimated that it may have had "doubts. . .about the interpretation given the Treasury Amendment in *American Board of Trade*," but believed itself constrained to follow its own precedent. Unfortunately, that inhibition, coupled with the Fourth Circuit's contrary opinion and diverging views of other courts, the CFTC and the United States Treasury, leaves market participants badly confused.[5]

with respect to accounts, agreements (*including any transaction which is of the character of, or is commonly known to the trade as, an "option"*, "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for a future delivery, traded or executed on a contract market designated pursuant to section 5 of this Act or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 19 of this Act. (Emphasis added).

[5] If, as the Second Circuit held, off-exchange currency options are governed by the CEA, they are illegal and unenforceable if not traded in compliance with the CEA. Although the so-called "swaps exemption" issued by the CFTC (17 C.F.R. § 35) provides some safety from this enormous legal risk, it only applies to certain types of transactions between "eligible swap participants." As noted in United States General Accounting Office Report to Congressional Requesters, *Financial Derivatives: Actions Needed to Protect the Financial System* (May 1994) ("GAO Derivatives Report") the swaps exemption "does not completely eliminate the risk that a swaps contract could be found to violate CEA." (*Id.* at 65).

The Second Circuit's reading is particularly untenable from a practical, commercial perspective because it makes CEA jurisdiction dependent on whether a currency option is exercised. Neither an option purchaser nor seller can know at the time of purchase or sale whether the option will be exercised. That is purely a function of the price movements of the underlying currency and the discretion of the option holder.[6] To decide, in the words of the Second Circuit, that the CEA governs an off-exchange currency option "unless and until the option is exercised" is to make application of the CEA solely a function of (1) the market forces which determine whether the option has any value and (2) the financial judgment of the option holder. This shifting jurisdictional definition cannot provide the predictability necessary for a smoothly functioning market and cannot be what the Treasury Amendment means.

Of additional concern to all market participants interested in uniformity, the Second Circuit acknowledged that its "interpretation of the phrase 'transactions in foreign currency' . . . conflicts with that of the Fourth Circuit in *Salomon Forex* v. *Tauber*, 8 F.3d 966 (4th Cir. 1993), *cert. denied*, 114 S. Ct. 1540, *reh'g denied*, 114 S. Ct. 2156 (1994)." The Sec-

[6] The GAO Derivatives Report (at p. 27) characterizes "options" as one type of derivative and discusses them as follows:

> Option contracts, which can be either customized and privately negotiated or standardized, give the purchaser the right to buy (call option) or sell (put option) a specified quantity of a commodity or financial asset at a particular price (the exercise price) on or before a certain future date. . .
>
> Options differ from forwards and futures in that options do not require the purchaser to buy or sell the underlying. A purchaser will not exercise an option until the market price of the underlying is greater than the exercise price for a call option or less than the exercise price for a put option. Options that are not exercised expire with no value.

ond Circuit suggested that "[t]his conflict is for the Supreme Court, not us, to resolve." Unlike the Second Circuit, the Fourth Circuit, in six pages of analysis, had found the phrase "transactions in foreign currency" "broad and unqualified:"[7]

> *[T]he Treasury Amendment applies to all transactions in which foreign currencies are the subject matter, including options.* Since trading in both futures and options involves foreign currency, albeit indirectly, there is no principled reason to distinguish between them. . . ."

Id. at 976 (emphasis added).

In *Salomon Forex*, a sophisticated, large scale foreign currency trader tried to avoid a $25 million loss from off-exchange transactions in currency forwards and options. The trader argued that because the CEA requires foreign currency futures to be traded exclusively on exchanges designated by the CFTC and options to be traded on CFTC or SEC designated exchanges, the off-exchange transactions in which he engaged were illegal and voidable. *Id.* at 973.

Having the benefit of *amicus* participation by, among others, the CFTC, the United States Treasury, the Foreign Exchange Committee, the Futures Industry Association and the Managed Futures Association (a trade group of major money center banks), all of whom argued against application of the CEA to the transactions at issue, the Fourth Circuit rejected the trader's claim. The Fourth Circuit found the contracts beyond the reach of the CEA and lawful.

Even apart from conflicting with *Salomon Forex*, the Second Circuit's jurisdictional boundary compounds an already-bewildering set of Treasury Amendment interpretations.[8] For

[7] *Id.* at 975.

[8] The Second Circuit's decision has not resolved the interpretation of the Treasury Amendment. After the Second Circuit's decision, the Fourth Circuit's *Salomon Forex* decision was followed in *Commodity Futures Trading Comm'n* v. *Frankwell Bullion Ltd.*, 904 F. Supp. 1072 (N.D. Cal. 1995) (off-exchange foreign currency transactions, regardless of whether they are "futures" or "spot trades," fall outside CEA jurisdiction).

example, some views of when the Treasury Amendment is to apply are based on whether the parties to off-exchange currency transactions are "sophisticated." The CFTC has itself stated that the Treasury Amendment excludes from the CEA currency transactions "among and between banks and other sophisticated, informed institutions." *Statutory Interpretation Regarding Trading in Foreign Currencies for Future Delivery*, 50 Fed. Reg. 42983 (1985). But courts are in conflict as to whether traders' "sophistication" should influence the scope of CEA jurisdiction over currency transactions. *Compare Commodity Futures Trading Comm'n* v. *Standard Forex, Inc.*, [1994 Current] Comm. Fut. L. Rep. (CCH) ¶26,063 (E.D.N.Y. Aug. 9, 1993) (holding that the Treasury Amendment did not exclude from CEA jurisdiction spot foreign currency contracts between an exchange and private, unsophisticated investors) with *Salomon Forex*, 8 F.3d at 978 ("We hold only that individually-negotiated foreign currency option and futures transactions *between sophisticated, large-scale foreign currency traders* fall within the Treasury Amendment's exclusion from CEA coverage" (emphasis added)); and *Frankwell Bullion*, 904 F. Supp. at 1076-77 (rejecting any difference in treatment of sophisticated or unsophisticated parties because "[t]he Treasury Amendment makes no distinction based on the identity or character of the participants" and because "a distinction between sophisticated large-scale investors and private unsophisticated investors would be arbitrary and nearly impossible to apply").

As is clear from the *amicus* brief of the United States in *Salomon Forex* (Appendix D to the Petition), the Department of the Treasury and the Securities Exchange Commission construe the Treasury Amendment to exclude a much broader class of currency transactions, including options, than does the CFTC. As a result, "whether structured as a future contract or an option" the United States supported the lower

court's holding in *Salomon Forex* that "[a]ll transactions in which foreign currency is the actual subject matter of an off-exchange contract for future delivery are exempt from the CEA" (*Id.* at p. 16d).

Plainly, *amici* and other market participants not only face court decisions which are in direct conflict but also a divided national regulatory authority. This confusion adversely affects an important global market in which the United States Government and American commercial interests are major participants. Clarification by this Court is urgently needed.

C. The Court of Appeals' Decision Conflicts with Applicable Decisions of this Court.

This Court has been a determined exponent of giving statutes their "plain meaning." Although the Court has not previously construed the Treasury Amendment, the Court of Appeals decision is a dramatic departure from the principles of statutory construction which the Court has mandated. "[T]he starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Consumer Prod. Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *Accord, Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 114 S. Ct. 1439, 1453-54 ("Policy considerations cannot override our interpretation of the text and structure of the [Securities] Act, except to the extent that they may help to show that adherence to the text and structure would lead to a result 'so bizarre' that Congress could not have intended it").

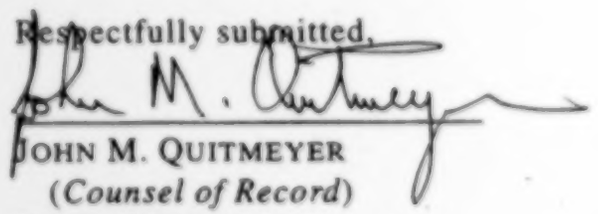
As discussed above, the Court of Appeals construction of the phrase "transactions in foreign currency" is not only tortured but also creates a continuously moving jurisdictional boundary. It plainly disregards the usual starting "assumption that the legislative purpose is expressed by the ordinary meaning of the words used." *Richards* v. *United States*, 369

U.S. 1, 9 (1961). And, as demonstrated, the Second Circuit's determination that the word "transaction" does not comprehend an "option" conflicts with the meaning given to "transaction" in an adjoining provision of the CEA. The Court of Appeals thereby violated "the normal rule of statutory construction [which] assumes that 'identical words used in different parts of the same act are intended to have the same meaning.' " *Sorenson* v. *Sect'y of Treasury*, 475, U.S. 851, 860 (1986), *quoting*, *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934). For this reason, as well, the Petition should be granted.

CONCLUSION

Off-exchange foreign currency options are presently traded in huge volumes in the United States and around the world. There is no more fundamental issue for participants in this market than whether the Commodity Exchange Act governs such foreign currency transactions. Two courts of appeals, one of which sits in a world financial capital, have reached opposite conclusions. Only action by this Court will resolve this important question. The petition for a writ of certiorari should be granted.

Respectfully submitted,



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